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THE FACTOR SYSTEM AS RELATED TO INDUSTRIAL COMBINATIONS

“People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.” From the time Adam Smith¹ wrote these words to the present day, any association of business men, whatever its ostensible purpose, has been the object of suspicion on the part of the purchasing public. There is a more or less vague feeling that a predatory motive is behind any movement toward a peace footing in the commercial world, and that the consumer pays in high prices for the truce. In recent years there has been little to lessen this apprehension. Notwithstanding all that has been said of the wastes of economic warfare and the saving made possible through combination and integration in industry, the honest citizen’s peace of mind is greater if he knows there is a competitive struggle between the purveyors of the goods he consumes.

When evidence came to light that industrial combinations, which largely controlled the production of many commodities, had gone farther in making arrangements to govern the jobbers and retailers who distributed the products, the monopolistic grip seemed to be tightening. Competitors were to be squeezed out, it was feared, and the general public left to the tender mercies of the trusts. Domination from raw material to shopkeeper’s counter was not to be looked upon with equanimity.

¹ *Wealth of Nations* (Bohn ed.), Vol. I, p. 134.

Various names have been applied to the similar plans adopted to enable the manufacturer to control the distribution of his goods by the jobber and the retailer—sometimes affecting the jobber only: the “factor system,” the “limited price system,” or the “restricted price system.” All of these are practically the same. The distributor buys from the manufacturer under conditions imposed by the latter. The manufacturer dictates the price at, and often the terms upon, which the goods may be sold. It is this extension of power to the limit of telling the consumer what he must pay for the goods, and from whom he may buy them, that is the subject of condemnation.

A majority of a committee appointed by the legislature of New York is emphatic in its statement regarding the prevalence, and in its condemnation of the character, of these methods of control in the case of trusts.²

An eminent professional economist describes the factor's agreement in equally unfavorable terms, and regards it as an instrument at the service of trusts that are attempting to gain exclusive control of the market.³ Occasional reference to the subject in current discussions indicates the same general opinion.

² “Every such combination [of formerly independent, competing concerns] was followed by a system of factor's agreements which enabled it to control the means of distribution and maintain a fixed price without regard to ostensible competition or to the normal rules of supply and demand. . . . The fiction of consignment is adopted to support a transaction which, in every essential element, is an absolute sale. . . . The system thus established places convenient agencies at the disposal of combinations with monopolistic tendencies to secure just that control over the distribution of the product, which, coupled with a practically exclusive control of the producing capacity of the nation, enables it arbitrarily to fix and maintain the price of the product to the people. This is the last link in the completed chain and an integral part of the whole scheme, which, in some respects, clinches the system and makes monopoly permanent by rendering competition impossible. . . . Combinations which are able to and do successfully put in operation a system such as has been here described, and for the purpose above indicated, are clearly oppressive.”—*Report of the Joint Committee of the Senate and Assembly Appointed to Investigate Trusts*, New York, 1897, pp. 14, 23, 35.

³ “. . . the trust may refuse to sell goods at all under certain conditions. It may boycott merchants who do not comply with its regulations; and one of its requirements may be that the merchants in turn shall boycott all independent producers. This is the basis of the ‘factor's agreement,’ whereby a trust which, within the wide variety of its products, has a number of things that are essential

The evidence given before the New York committee shows that methods of fixing prices and restraining jobbers were employed by the American Sugar Refining Company, the soda combination, the United States Rubber Company, the National Wall Paper Company, and the tobacco trust. That similar plans were followed by the baking-powder, the photographic supplies, the plate glass, and the whiskey combinations is indicated by the testimony taken before the Industrial Commission.⁴ From the reports of these investigations it is possible to obtain a knowledge of the conditions which prevailed at the adoption of the systems by the trusts, of the source from which the initiative came, and of the character of the goods to the distribution of which the plan was applied.

One of the earliest instances of the employment of the factor system by a trust was its adoption by the American Sugar Refining Company. Competition between jobbers handling sugar was so keen that the price was reduced to net cost, involving a loss of the expense of doing the business and threatening bankruptcy to many of the dealers. Efforts were made by the Wholesale Grocers' Association to agree upon a price that would allow a profit, but it was impossible to enforce the agreement. When one had cut the price all had to follow. An appeal was then made to the refiners with the result that the "factor system" was introduced; a scheme by which the jobbers were assured a profit of eighteen and three-fourth cents a hundred pounds if they complied with certain conditions, chief of which was the maintenance of a fixed price. A desire to maintain the solvency of the jobbers was the reason of the refiners' action, and the amount of the rebate was based upon the calculation that it would cost that sum for the trust to distribute its product directly to the retailers.

In this system the jobber formally requested to be made a "factor," and agreed to act as such, though, in fact, he paid for

for a merchant's business, either refuses to sell him anything or refuses to give him necessary discounts, if the merchant buys goods of any description from a competing establishment."—J. B. Clark, *Control of Trusts* (New York, 1901), p. 34.

⁴For reviews of the testimony see the *Report of the Industrial Commission* (1900), Vol. I, p. 21; (1901), Vol. XIII, pp. xxiii-xxv.

his goods and the expense of handling in the same manner as when he bought them outright. He was forbidden to incur any expense on the trust's account. His position differed from the ordinary purchaser's in that the possibility of obtaining a profit on sugar he marketed depended upon his compliance with the trust's regulations, and he had to wait until the end of the fixed period before receiving his rebate. He agreed not to sell sugar at less than the trust's daily quotation plus the freight charges from the refinery to the purchaser's railroad station. The amount of the freight charges was indicated in the *Equality Rate Book*. No more liberal terms in regard to credit, or cash discounts, than the prescribed ones were to be given. Orders were to be filled at the price ruling the hour and minute they were taken. Sugar was to be billed on separate invoices. A jobber who made an affidavit that he had complied with these and some other minor conditions was entitled to receive a rebate of three-sixteenths of a cent a pound.⁵

⁵ The entire arrangement was put in formal shape, about 1895, by drawing up "the factor's agreement," the "acceptance" of it, and the affidavit which was sworn to by the jobber. These papers were supplemented by a *Uniform Code of Rules for the Sale of Sugar under Factor Agreement*. The *Equality Rate Book* was compiled to prevent discriminations by allowances for transportation charges. For the testimony from which the above is summarized see *Investigation* (New York), pp. 128-30, 345, 413, 418, 815, 816, 827, 839, 856-60, 1059-65, 1072, 1073, 1124-28; also, *Report of the Industrial Commission*, Vol. I, "Testimony," p. 55. If a jobber declined to become a factor he could not buy sugar at as low a price as his competitors who had signed the agreement. In one case the difference amounted to fifty-two cents a hundred pounds. The grocer refused to become a factor because he did "not think it was a right way of doing business; it stifled competition." Jobbers were compelled to buy from the trust or from foreign refiners. The latter's sugar was usually somewhat inferior to the domestic product and did not command as high a price; but the factor's agreement fixed the price proportionate to the value of the better, so that a dealer could not sell both. However, the witness had not suffered financial loss because he bought sugar from outside sources; in fact it seems to have made little difference, except that it cost him some inconvenience to preserve his "independence as a business man." See, *Investigation* (New York), pp. 1059, 1065, 1072, 1073.

In Ohio, the law of 1898 forbade withholding the rebate or making any agreement to fix prices (*Report of the Industrial Commission*, Vol. I, p. 155; Vol. II, p. 201). The three-sixteenths of a cent a pound was deducted from the face of the bills of sugar shipped into the state and the grocers were left to get a profit on sales if they could. The jobbers divided the state into districts, and a committee was appointed in each to secure a margin if possible. They sought

The later increase of competition between companies engaged in refining has prevented any attempts at enforcing the agreements. In some parts of the country the system is followed with a degree of faithfulness; the refiners who entered the business after its establishment formally adopted it, but there is a good deal of price-cutting that is allowed to go practically unnoticed.

The rebate system, or factor's agreement, has been especially prominent in the business of the wholesale grocers, and they have made strenuous efforts to extend the scheme to the sale of a certain class of goods which they handle. The following resolutions indicate the reasons for their action.

Whereas a very large and increasing proportion of the goods handled by wholesale grocers are manufactured articles of uniform quality and quantity in each package, and

*Whereas, under the laws of modern competition it is impossible to obtain a profit on such goods*⁶ . . . be it

Resolved, That this convention believes that a limited price and rebate system is necessary, just, and in the interest of all concerned;

Resolved, That a committee of five be appointed to consider all systems now in vogue, and to prepare such a system as, in their judgment, will be in the interest of all concerned, and then endeavor to procure its adoption by all manufacturers whose goods we handle.⁷

Three forms of factor's agreements or rebate systems of varying stringency were drawn up or selected from existing ones, and the adoption of any one of them was urged on manufacturers.⁸

to obtain an eighth of a cent a pound. If a grocer cut prices in one of the districts, it was agreed that his competitors should cut to meet his prices in that section. Thus without sacrificing profits over the whole state, they hoped to get the offender to restore rates. A circular sent out by the Wholesale Grocers' Association says: "Under present conditions it is impossible to get support from the refiners in regulating the cutter and rebater. Therefore it is left to the honor and good sense of each jobber as to whether or not a profit on sugar shall be obtained in the future" (*Report of the Industrial Commission*, Vol. I, p. 156).

Chicago grocers had a similar plan in their business and on the whole it helped to maintain a small profit (*ibid.*, p. 157).

⁶ The italics are the writer's.

⁷ *Report of the Industrial Commission*, Vol. I, pp. 59, 60.

⁸ Among these was the contract that had been introduced by Proctor and Gamble. It provides that card rates on their soaps shall not be cut, directly or indirectly; that prices shall be changed upon receipt of notice; that the signer

The soda combination's system differed somewhat from that employed by the sugar trust. The device was the one used by the companies that united to form the combination; the soda trust had not signed any of these contracts; it merely continued the plan it found in operation.⁹ The provisions of the contract of interest in this connection were: that prices should not be cut in selling their brands; that other brands should not be sold at a lower figure; and that the sale of cheap, bulk soda should not be pushed, but handled only to the extent made necessary by actual demand.

An effort to control the market to the disadvantage of competitors appears in the terms of this agreement. The company, however, asserts that it was the intention to prevent jobbers from merely carrying its goods in stock while actively promoting the sale of other, less well-known brands upon which they could make a greater profit. The company was willing to take the trouble to operate the system because insuring the jobber a profit would lessen the tendency to push the sale of other brands on which a gain could be made.¹⁰

of the contract shall not supply with Proctor and Gamble's soaps any dealer who has not signed the contract or is violating it; that evidence shall be given on demand if a dealer is accused of failing to keep the agreement, a refusal to do so being deemed conclusive proof of the charge; a fine of fifty dollars must be paid by the violator before he can obtain more soaps from the company. Of all the plans for limiting prices this has been the most carefully kept. It was one of the first employed and the company has rigidly enforced it. (*Report of the Industrial Commission*, Vol. I, p. 62.) Recent correspondence with Proctor and Gamble indicates that their opinion and policy are unchanged.

⁹ In 1899, the Wholesale Grocers' Association sent a committee to one of the then independent firms, John Dwight & Co., in order to arrange, if possible, a plan by means of which a profit on this company's package soda might be secured. Competition in the sale of this brand had become so keen that there was no margin in handling it. In order to get a profit on the large sales of this popular brand the grocers agreed to sell all brands at the same price if the rebate system were adopted. The company complied with the request, and agreements were drawn up that were binding in New York and New Jersey. A similar agreement was afterward made with the other company which, later, became part of the trust.

¹⁰ Jobbers, previously, had employed other manufacturers to pack soda for them under private brands and endeavored to put these on the market. This plan was generally abandoned after the establishment of the factor system. There

The "memorandum of agreement" between the United States Rubber Company and its customers is not discussed at sufficient length in the evidence to give a clear idea of its operation. Moreover, the system was received by the trust from the independent companies which were consolidated. It is therefore left without further mention.¹¹

Each of the varying plans tried by the National Wall Paper Company, in the end, "demonstrated its inability to control the middleman or jobber, who failed in many cases to live up to his contract to maintain prices."¹² There are generally no copyrights on designs which change from year to year. There is no definite brand or article of which consumers become habitual users. There is no customers' demand which forces jobbers to handle a particular company's wall paper. It was impossible for the manufacturers to bring any effective pressure on the distributors.

The efforts made by the tobacco combinations to control jobbers and prices differ from others in that there was no written contract; a verbal declaration or offer was made to the same end. The system was introduced at the instance of the wholesale grocers.¹³

The trust attempted to enforce exclusive sale of its brands by cutting off the supply of jobbers who handled goods of other

was doubtless greater advantage in handling the rapid-selling, popular goods than in trying to put unknown brands in the hands of retailers, even though the margin of profit on the latter was wider than on the former.

For the evidence touching the soda combination's system see *Investigation* (New York), pp. 442-46, 541, 588.

¹¹ For the text of the agreements see *Investigation* (New York), pp. 646-52.

¹² For the case of the National Wall Paper Company see *Investigation* (New York), pp. 690, 805; *Report* of the Industrial Commission, Vol. XIII, pp. 283, 284, 287.

¹³ The president of the Wholesale Grocers' Association requested the Continental Tobacco Company to fix the price at which jobbers should sell to retailers in New England. Profits had been wiped out by severe competition. Mutual satisfaction was secured by fixing prices which would yield jobbers a profit of two cents a pound, with a discount of 3 per cent. additional, if trust brands were handled exclusively. Some jobbers forfeited the discount by selling other brands. The terms were then changed to one cent a pound with a discount of 5½ per cent. additional for exclusive sale. One cent would not pay the expenses,

makers. One firm, 90 per cent. of whose tobacco business was in brands controlled by the trust, was refused goods because it would not handle them alone. The company said, "they had concluded it was not to their interest to maintain business relations" with the firm. A jobber complained that retailers fear to buy independent makers' goods lest they be cut off from the trust's brands which constitute the bulk of their sales.

The trust officials declare that the jobber is of little importance in selling their goods. The dealers are only distributors in response to demands of consumers. The tobacco manufacturer goes directly to the user of his goods and by creating a demand for particular brands, makes it to the interest of the jobbers to handle his goods.¹⁴

The photographic supplies combination dealt directly with the retailer in most cases, and made it a condition of sale that list prices be maintained. A trade discount of 15 per cent. was given purchasers. About the twentieth of each month a memorandum of his purchases of photographic papers, during the previous month, was sent to each customer. If this was certified to and returned a rebate of 12 per cent. was given. But it is a condition of this "memorandum" that the dealer declare he has not, within the four months preceding its date, handled printing-out or developing-out papers sold by anyone outside the combination.

The terms of sale state that the extra discount is offered because it is advantageous to the trust to have its "specialities sold in original packages and at a price that affords the dealer a profit large enough to warrant his energetically and exclusively pushing their sale." The scheme was taken over by the trust from the companies that united. At the organization of the com-

so that the dealer had to have the discount. Moreover the trust controlled the brands under which 80 to 90 per cent. of the tobacco sold in New England was marketed; dealers could not afford to reject the offer. It was withdrawn in Massachusetts after the introduction in the legislature of a bill providing that no conditions of sale should be made which require the purchaser to discriminate against the seller's competitors.

¹⁴ For the evidence touching the tobacco combination see *Report of the Industrial Commission*, Vol. XIII, pp. 310, 311, 316, 330, 333, 335. For the contract affecting the sale of cigarettes see *Investigation* (New York), pp. 871-83; 911-23.

bination, a circular letter was sent to dealers throughout the country, asking them if they liked the system. Almost all of them replied that it was beneficial and favored its continuance. It is hardly to be doubted that, if there were no regulating control over dealers, these goods would soon be on a profitless basis.¹⁵

Descriptions of the rebate systems used by the Pittsburgh Plate Glass Company and by the whiskey trust would add little that is different from the preceding accounts. The testimony in relation to the methods of selling employed by these combinations may be found scattered through the *Report* of the Industrial Commission.¹⁶

If one turns from reports of official investigations to trade papers some additional light is thrown on the essential features of the limited-price system. The hardware dealers have faced situations similar to those that confronted the wholesale grocers, and the methods of seeking relief have been quite similar.

At a joint meeting of the Southern Hardware Jobbers' Association and the American Hardware Manufacturers' Association, one of the jobbers, addressing the manufacturers, declared

an unfortunate condition prevails among the jobbers concerning margins on certain lines that go far toward making up the bulk of our business, and we are here today in the peculiar and anomalous attitude of asking to be saved from ourselves.

All of you are advised that we want you, when it is at all feasible, to arrange your method of handling your product to the end that the jobber will be compelled to make a reasonable margin when he makes a sale. There

¹⁵ The method adopted to bring pressure on dealers in order to force them to handle the trust's papers exclusively takes its form from the circumstances of the case. The combination controls by patents certain very popular cameras and specialties. A dealer in photographic supplies only could scarcely do business without them. But the cameras cannot be bought by a dealer who does not handle the trust's paper exclusively. The option is to sell the combination's complete line or none of its goods. The demand from consumers makes it practically necessary for the dealer to accept the terms offered him.

For the source of the account of the photographic supplies combination see *Report* of the Industrial Commission, Vol. XIII, pp. 174, 192 and note, 193, 198.

¹⁶ "Pittsburgh Plate Glass Company," *Report* of the Industrial Commission, Vol. XIII, pp. 208, 218, 219, 221, 227, 229, 230, 245; "Whiskey Combinations," *ibid.*, Vol. I, pp. 176, 206, 211, 241, 251. Citations to other cases where trusts have used a factor system would tax the reader's patience.

will be no injustice done to any of us, but rather it will be a favor that will earn our everlasting gratitude.¹⁷

It was suggested that any scheme adopted should involve loss of rebate and "a good, stiff fine" as a penalty for violation; or, better, the offender should be cut off from supplies. The speaker in an article, later, asserts that his experience in the wholesale grocery and hardware trades showed that a profit might be had under a limited price system, though the margin was narrow at times; and that a vigorous policy would maintain the system. Many articles were being handled at cost by the jobbers. The latter are necessary to the manufacturers and should be protected. Moreover, they should be consulted in determining the amount of the margin that might be adopted in the various sections of the country. Jobbers in the South and Southwest would expect to make a larger percentage of profit than would the dealers who are nearer the manufacturing centers and therefore do not need to anticipate wants as far ahead of time.¹⁸

At the Savannah supply and machinery meetings of 1905, in a session of manufacturers and dealers, a manufacturer discussed the question of limited prices at some length. He asserted that the establishment of minimum prices has resulted in securing and maintaining the confidence, friendship, and co-operation of dealers; it has prevented "useless price-cutting," created uniformity in quotations, and materially aided in "the maintenance of prices;" moreover, the demand for the product of the manufacturer is enhanced. "The legitimate machinery dealers" prefer the system, and while it is hard to control some merchants, they can generally be kept in line by withdrawing quotations or by putting them on the same basis as consumers. The consumer may be benefited by cut prices, but the bickerings and complaints that accompany an unregulated system indicate the strength of the purchasers' dissatisfaction. There is sure to be discrimination in the absence of regulation.

The result of the discussion was the following resolution:

Resolved, In joint session of manufacturers and supply dealers it is the sense of the meeting that we favor the establishment by manufacturers of

¹⁷ *Iron Age*, June 15, 1905, pp. 1936, 1937.

¹⁸ *Ibid.*, p. 1949.

minimum selling prices whenever practicable: and that manufacturers who will adopt the system notify the association and submit their plan.¹⁹

The *Iron Age* in 1905 published extracts from a number of letters written by jobbers, touching the merits of restricting prices. In the main the opinions were favorable, though it was pointed out in many cases that an application of the plan to all lines of goods was not advisable. On the other hand, it was necessary to restrict prices on some items in order to save the cost of doing business. A long list of articles mentioned by the correspondents as ones to which the plan could be applied suggests the prevalence of price-cutting.²⁰

In most cases where the plan was adopted the margin was made too small to permit all the business to be done on that basis. It seemed to many that it would be better to establish the price on close-selling articles and allow the jobber to make more on the lines that would bear a heavier rate of profit. In general, it costs about 15 per cent. to do business. One-half of all staples marketed are sold at a margin of 5 to 10 per cent. The balance must bring a profit of 30 to 40 per cent. in order to raise the average to 20 per cent. It would be impossible to bring the manufacturers to the point of allowing 25 to 30 per cent. on general supplies; hence the advisability of establishing minimum prices on only the lines where profit had disappeared.

There was a general agreement that the system tended to decentralize trade because it forced the large jobber to make the same price as his small rival, thus preventing the invasion of local territory by distant houses. There is a strong tendency to patronize the local dealer unless inducements of lower prices are offered by the outsider. One company had established branch houses to secure local trade because of the adoption of the plan, it was alleged.

The scheme was believed to be favorable to the small dealers in their struggle with "the mail-order houses."²¹ The latter

¹⁹ *Iron Age*, May 4, 1905, pp. 1448, 1449.

²⁰ *Iron Age*, July 20, 1905, p. 191; July 27, p. 253; August 10, pp. 385, 386.

²¹ The efforts of the National Hardware Association in this direction are shown by the following extract from a circular sent out by the secretary: "The

sends its huge, illustrated book of prices throughout the country and competes with local dealers wherever there is mail, express, and freight service. The low prices on well-known goods offered in these lists tend to take the trade to the large dealer. If the latter were forced to sell at a fixed price, the same at which the small merchant markets the goods, the local business man would make the sale.²²

One jobber writes that new conditions are developing through improvements in communication and transportation, and older methods of selling will have to be abandoned. The manufacturer has an interest in his products until they reach the consumer, so that control of prices seems to be imperative. Salesmen underbid each other until there is no profit left. These goods are then sold only in cases of extreme necessity. Others are substituted in order to secure a profit, and jobbers try to introduce private brands. The manufacturer will have to protect himself by protecting the jobber. If the former wishes to keep his goods permanently on the market he must see to it that it is profitable to handle them. Otherwise, he will find the distributors arrayed against him in endeavoring to persuade the consumer that another article is "just as good," and the efforts to create demand through advertising will be largely offset.

statement is being made that notwithstanding the efforts of manufacturers to prevent their goods reaching the hands of catalogue houses, these parties are receiving large consignments. In contradiction of this statement, we have in our hands at this moment an original letter written within four days by . . . to a customer in which they say: 'Our stock of . . . arms is at the present time very low, and we refer you to the . . . repeating rifle which you will find, etc.'

"You will see that . . . admit being unable to furnish the . . . gun, and this is due to the fact that the . . . Co. has endeavored to compel them to respect their wishes concerning selling prices."

²³ The following extract from a letter written by the head of a well-known mail-order house is pertinent:

" . . . so far as I know I believe that it has not been possible—except in very few instances—to protect the market for those manufactured articles; therefore the plan is inoperative except for patented articles.

"My own personal belief is that the interest of the consumer is better served without restrictions upon the owners of merchandise."

There was no explanation of the reason for this belief. It is to be observed that "patented articles" and copyrighted brands are numerous.

One strong objection urged by some correspondents was the difficulty of enforcing any rule of this kind. Many jobbers would cut secretly. One jobber wrote that the restriction held in case of ammunition, "but we do not know another single item where prices have not been privately cut by jobbers."

An opponent of the system declares that the scheme, "if not immoral, in our part of the country, certainly is illegal." He believes that it is not for the best interests of the retailer, hence is not favorable to the jobbers, and puts a premium on trickery. There is not a full explanation of these opinions.

Some opposition arises from the small jobber who buys a stipulated amount in order to obtain the minimum price, and then unloads the surplus by cutting prices and giving rebates.

The plan adopted by a company manufacturing wagons indicates the method of maintaining prices in one case. The company has a "gentleman's agreement" with the dealers in a given territory. In case of failure to keep faith the offender is "interviewed," usually with success. The nature of the interview is not stated.²³

A well-known manufacturer, in response to inquiry, writes that he has favored the application of the system of restricted prices to scattered transactions, where the volume is small, not to the most important part of his business. His products, railway and mill supplies, could hardly be sold in all cases under fixed rules, because competition would prevent the successful operation of the scheme. On the other hand he remarks, staple goods, groceries, etc., could hardly be sold conveniently under any other system than this.

If a manufacturer has . . . absolute control of a commodity, either by patent or other form of monopoly, he can sell under this system or not, as he chooses. . . . On the other hand, where there is severe competition on any particular article, whether the competitive article be of different design but accomplish the same purpose, or whether one article is an "imitation" of another, . . . this limited price system will weaken.

The largest consumers, railroads for instance, prefer to buy direct from the manufacturer to save the middleman's profit. . . . If one manufacturer

²³ *Iron Age*, January 31, 1907, p. 8. For a later discussion, see *ibid.*, July 4, 1907, p. 71.

is obliged to protect a margin of profit to a jobber or dealer in selling these large consumers he is greatly handicapped [if his competitor sells direct].

. . . . This system will operate advantageously on scattered business, as purchasers buying only small lots for their immediate needs are willing to purchase locally from the dealer's stock. The dealer carrying stock should be given a fair price that will afford an ample margin of profit and should be protected in price as far as possible, it being understood that there are certain large consumers to whom he cannot sell, and for this business the manufacturer cannot fix a price that will permit a profit to the dealer.

From the above you will note that the limited price system is only partially advocated, but this opinion is based purely on the writer's experience with a line of goods that is so fully introduced that it has come to be almost a "standard commodity," whereas five years ago it was entirely a "specialty."

The output of our factory was sold entirely on the "limited-price system" five years ago. The writer advocated only a partial use of this system, as has been explained above, and the selling method was changed. The results have . . . been extremely gratifying.

This, however, is simply the experience of one of many, and while others may have totally different results, yet the writer cannot but believe that any system that ties the hands of the manufacturer, or involves him in a contract that is not sufficiently elastic to let him loose where he is obliged to fight, cannot possibly be advantageous or profitable to the manufacturer.

A firm, manufacturing textiles, discusses its policy, in a recent letter, as follows:

In creating a new fabric which is to be advertised to the consumer, and sold at the same price, it is our custom to allow the retailer a fair percentage of profit, and place a contract on the sample card from which the order is taken, on the invoice which is delivered to the retailer, and on the piece of goods. As a rule, the contract reads as follows: "This piece of goods is purchased under an agreement that it will be retailed at (price)."

If this method of restricting the selling price of any advertised article were not pursued, it would be impossible to promote any individual fabric, or branded article, as if there are four merchants in a town, and three of them are doing a large business on a given article, and the fourth should buy a limited quantity of this article, he could readily afford to advertise it at a ridiculous price and hereby, in self-protection, force his competitors to give up the sale of this article, which they would do, no matter how desirable it was, and how good a value it was, both for them and the consumer.

As a matter of fact, the selling of advertised merchandise at a restricted selling price, acts not only in favor of the consumer, but also in favor of the retailer, and insures the keeping up of a certain standard of the merchandise sold.

We have had many minor suits [in the courts] in past years on this point,

and they have all been decided in our favor. As a matter of fact, the only cases of this character which we have had, have been against more or less irresponsible firms, and against those who tried to trade on the reputation of others.

It makes little difference to what line of business one may turn; he will find profitless prices on some kinds of goods and usually an effort to establish control that will enable the distributors to get a return for their service in passing articles to the consumers. A notable case is that of the retail grocers in the states along the Pacific. They have seen the margin of profit on so many staple articles narrow to the vanishing line that it seemed time to do what they could in self-defense. They have called their scheme "The Pacific Coast Plan." In substance it is similar to the others that have been noted, but the form is somewhat different.

The manufacturer is persuaded to fix a minimum price at which the goods are to be sold to the consumer and upon the outside of the case containing his products is pasted this notice:

NOTICE TO PURCHASER

The goods contained in this case are sold on the condition which is made a part of the consideration of the sale, that the purchaser if he retails them, will maintain our fixed retail price on these goods, and if he wholesales them he will sell them subject to the same condition. The acceptance of these goods containing this notice is sufficient evidence that the purchaser is familiar with these conditions and will abide by their requirements.

Our established retail price on is

A similar notice is placed within the case and letters are sent to the jobbing trade as well as to the Pacific Coast Retail Grocers' Association, notifying them of the manufacturer's action. These notices give the jobber and retailer full knowledge of the conditions under which he buys and must sell the commodities.

The Grocers' Association asserts in its circulars that the manufacturer has an interest in preventing his popular brands from being cut in price to advertise other goods, because eventually they will be discriminated against by all dealers who will push the sale of other brands upon which they can make a profit. It is argued that each line of goods should bear its own burden of cost of distribution. Again, the manufacturer is told that of

the 286 advertised articles of food upon the American market, protected by trade-marks, about fifty are prominent. The manufacturers of the latter find them brought to the notice of the public only to be sold without profit to the distributor. The latter reaches out for other brands to displace the advertised goods and the antagonism neutralizes the value of the advertising "at least 50 per cent." The manufacturer is asked to make "a reasonable and honest allowance" for the cost of distribution.

Many jobbers indorse the plan and some manufacturers have adopted it. Practically every well-known brand of flour manufactured in California is sold at limited prices.²⁴

At a recent meeting of the National Association of Retail Grocers the following resolutions were proposed:

Whereas, the exigencies of trade require that a dealer meet the prices of his direct competitors; and,

Whereas, the price made by cut-rate stores on leading staples have resulted in lowering the general average of profits on these staples far below the safety point; and

Whereas, conditions are now such that a general rehabilitation of prices is essential; and

Whereas, an agreement among retail grocers themselves is impracticable in many communities, since it can only be obtained by the agreement on the part of the wholesale grocer to refuse to sell goods to the cutter; and

Whereas, the legal right of fixing and maintaining the minimum selling price on an article rests with the manufacturer, and the manufacturer alone; and,

Whereas, all recent decisions have given the individual manufacturer the right to establish a retail price, as long as he is acting without an agreement, therefore,

Be it Resolved, that we, the national retail grocers in convention assembled, request that all the manufacturers of all leading specialties study their legal rights on this question, and adopt such a policy, as far as their legal rights will permit.

The presentation of the resolution stirred up a vigorous discussion, pro and con, some of it evidently resting on a misapprehension of the significance of the proposed request. The proposal was rejected by a vote of 83 to 67.²⁵

²⁴ *The Pacific Coast Grocers' Magazine* (Alameda, Cal.), June, 1906.

²⁵ *The Inland Grocer* (Cleveland), February 23, 1907, pp. 13-21. Current issues of this journal are likely to contain discussions of the subject.

An examination of this summary of the facts concerning representative systems of controlling prices shows some differences as well as likenesses that are worthy of notice. The plan has been adopted in some cases by the manufacturer on his own initiative; in others at the request of the jobber, and, in still others, because the retailer earnestly desired it. The scheme has been employed by individuals, by independent firms, and by trusts. It has been applied to the distribution of the entire output, or only of the portion that is handled by the middleman, while the producer makes what price he will in selling directly to large consumers. It has been employed in the sale of a staple such as sugar; to the business of selling wall paper, the value of which changes with the seasons (here it was unsuccessful); and to the marketing of goods which are uniform in quality, put up in definite-sized packages, and offered under a well-known brand or name. Soda, soaps, and photographic supplies are in this class of articles. In some cases there have been attempts to add to the control of prices specifications that were intended to exclude competing commodities.

The system was applied early to the sale of the last-mentioned class of goods by independent firms which saw that the jobber's interest must be guarded if they were to escape discrimination due to his pushing the sale of other, rival products. In cases where the manufacturer, by judicious advertising, or otherwise, had created a demand from consumers for his output, his brand became a staple article in the jobber's trade. Its value was well known. By cutting the price the jobber could attract the retailer and sell to him, at a profit, other goods whose value was less certain. It became a "leader," in trade parlance, and the retailer knew that he was getting a "bargain" when he was offered the lower price. In time all jobbers would meet the new price and its lowness would lose its stimulating effect.

When a price had been cut to cost, the jobber was unable to raise it; but by substituting another brand of the same or similar goods he frequently could secure a profit. While this was difficult to do in many cases, as far as it was done, it was obviously to the disadvantage of the maker of the goods called

for by the consumers. The distributor was working directly to the injury of the manufacturer of the popular products. To avoid this action by jobbers manufacturers were willing to arrange the plan that has been described in the preceding pages. The reason for the various names, "rebate," "limited price," or "factor" system is evident. Through this device the jobber was insured a margin that would remove the incentive to work in other brands, and would make it worth while for him to sell freely the standard goods. This margin, though fixed at a small percentage in most cases, through the volume of sales, became large enough to induce the dealer to abandon the policy of substitution. It has been under circumstances of this character that the system has been most successful.

The retailers' experience has duplicated that of the jobber. To attract the consumer staples have been made "leaders" by some merchants and in a short time all are selling the goods at profitless prices. Resort is had to the manufacturer to save them from what seems to be an inevitable result of competitive action.

The failure of the scheme in the wall-paper business indicates the importance of consumers' demand for a specific article as an element essential to the success of the plan. Without this pressure on retailers and jobbers the conditions demanding or permitting the operation of this method of control are incomplete. Purchasers were not educated to the point of asking for a particular brand of wall paper. It was impossible for the trust to force jobbers to sign the agreements and of little or no advantage to the jobbers to accept the proposal, or to keep the agreement if made. There was no place for the regulation of prices in this situation.

In the case of the sugar trade, the trust, at the time the adoption of the plan was urged by the wholesale grocers, practically controlled production. It was a matter of indifference to the refiners what the jobbers did about prices, as far as putting the commodity on the market was concerned. The trust made all that was consumed and there might have been an advantage to it from increased consumption if jobbers sold at cost or less. The trust's main concern was in regard to the safety of its out-

standing accounts. The jobbers had difficulty in securing the adoption of the scheme. At its best the plan assured them a sum only equal to what it would have cost the trust to provide efficient distributing agencies. With all its formal completeness, independent refiners came into the business as readily as if the scheme had not been put in operation.

In the action of the retail grocers of the Pacific Coast there is no suggestion of advantage to any trust or combination of producers.

From a survey of the instances in which it has been tried it is evident that the factor system, as far as it is concerned with the regulation of prices, has been practically of no utility in securing or maintaining a monopoly. Monopolistic influences from other sources, such as copyrighted names, trade marks, brands, or dominance in production, are necessary conditions of its existence.

A system of rebates may be used, as it is by the photographic supplies combination, to force the exclusive sale of one article by extending to it the influence over the dealer which popular demand for another of its products has given the trust. Similarly, the tobacco trust attempted to promote the sale of its products by compelling the dealer to choose between handling its goods exclusively or not at all. It is necessary to distinguish a plan for limiting prices from a scheme to secure special facilities by offering special inducements.

The effects of the factor system on the various classes of persons concerned are to be taken into account in estimating the value of the plan from the economic point of view. The manufacturer and his competitor, the distributors, including the jobber and the retailer, and the consumer are deeply interested.

As a generalization of commercial experience one may formulate the law that, with unrestricted competition, under modern conditions of easy communication and transportation, any commodity whose value is certainly known to the purchaser will tend to be distributed without profit, and perhaps with a loss.

The manufacturer of such goods has, at first, the advantage of increased sales of his product due to the lower prices, while

the consumer's expenditure yields him more satisfaction than before. The burden falls on the jobber and the retailer. As soon as this is evident the latter endeavor to protect their interests. There are two methods open; first, substitution of similar goods whose value is not as well known to purchasers and hence allow an opportunity to secure a profit; second, placing the burden of the cost of distribution of all the goods upon the lines that vary so much in quality that the consumer cannot readily determine their value. The latter expedient is the familiar one of charging what the traffic will bear. Dealers make no pretense of getting the same rate of profit on the different lines they handle; on teas as compared with sugar, for example. If the distributor survives he is evidently employing one or both of these devices.

The effect on the manufacturer of the first of the distributor's expedients is evident. Sales that were stimulated by "cut prices" begin to drop off when the jobber or the retailer exerts himself to persuade the purchaser that another article will answer his purpose. The dealer lets his stock of the profitless article run down and is frequently out of the goods when they are demanded. The pressing need of the consumer and the persuasion of the dealer often result in the displacement of the goods asked for by another brand. The efforts of the manufacturer to enlarge his business are checked and a rival's interests are advanced. There is nothing in law or morals that would justify an enactment preventing a manufacturer from protecting himself under these conditions by a system of limited prices. To do so would be to penalize the enterprise that created the popular goods.

In case of attempted substitution the consumer may be put to some inconvenience and annoyance in trying to secure exactly what he desires. He may have to spend carfare and time in going to another part of the city to a "cut-rate" store, because the dealer in his neighborhood is "just out." How far his saving through lower prices will pay him for this trouble will vary with circumstances. If a substitute is accepted the purchaser may be better or worse off, depending upon the quality of the article he has secured. If it is equal to the displaced commodity he may have made a positive gain, especially if the price is lower. In

this way a new variety of goods may be placed on the market and the consumer's range of choice widened advantageously. However, it is difficult and unusual to get the same amount of satisfaction out of a substitute that could be had from goods to which the purchaser is accustomed. It is rare that a cook has the same "luck" with an unknown baking powder as she has with a brand that she has been led to believe is "absolutely pure." A fountain pen represented to be "just as good," is charged with offenses that would be accepted as inevitable if a standard one were being used. The purchaser may gain or lose by substitution.

It is evident that introducing a new brand means the expenditure of considerable effort on the part of dealers. Some diplomacy and frequently more or less chicanery are essential in artful persuasion that the article recommended is equal, or superior, to the one asked for.

If the second alternative is taken, namely, making some goods carry the burden of handling all of them, the outcome will be favorable to the manufacturers of the profitless articles and injurious to the other manufacturers. The sale of the former's products tends to increase while the consumption of the latter's output will be checked by the higher prices. The distributors will have a great deal of trouble in making the adjustment while the consumer will be no better off in the long run. The margin will be widened on some lines while it is narrowed to extinction on others. The average cost of supplies to the general consumer would probably vary but little though for the worse, while shrewd buyers, using large proportional amounts of the profitless goods would be better off temporarily, perhaps permanently.

It is evident that neither of these schemes works satisfactorily. The distributor finds the difficulties of substitution and adjustment of profits are very great; so great that in ordinary lengths of time he is unable to get the system into harmonious working. If conditions remained relatively stable in respect to consumption, in the long run, an adjustment would doubtless be had that would be fairly satisfactory, but in the comparatively short periods that are involved, the pressure rests on the jobber and the retailer and is not distributed.

The factor system is brought forward to make an adjustment that would not be reached by the unmodified operation of economic forces. The restriction of prices does not mean that competition shall cease and a monopolistic condition prevail. Back of it is the notion that when the ideal of competition, i. e., that the reward of effort shall approximate its cost, cannot be attained without regulation, then regulation is necessary. If formal agreements are illegal, limitation of prices can easily be attained by other and lawful methods that do not necessitate an agreement.

There is no likelihood that the consumer will suffer through restricted prices. The manufacturer will not protect the distributors in getting an excessive rate of profit. The interest of the former will demand an extension of sales that would not be possible if the jobber or retailer were securing an unreasonable margin. The balance of these interests will protect the public against injury.

If there were evidence leading one to believe that cutting prices on staples to cost, or involving loss, is a necessary step in introducing more economical methods of distribution, there would be good reason to condemn systems of regulation. If merely fixing the wholesale or retail price of a good would interfere with the sale of competing commodities in a way that would prevent the consumer from exercising free choice in purchasing, there would be cause for objection on the part of the public. If a policy of baiting the hook of trade with profitless prices on some articles were essential to the survival of the fittest in the commercial world, an argument might be made for restraining those who interfere with the practice. The facts, however, do not indicate that this is the case. The field of competition is wide and a check in this respect would simply turn the force in another direction.

In respect to the features of some factors' agreements that limited the dealer to the sale of a manufacturer's products to the exclusion of those of rival producers—whether this was accomplished by direct specification, or by variation in the amount of the rebate allowed—there are decided differences of opinion. Professor Clark denounces the system in vigorous terms as a

"boycott" of the dealer who does not become a factor, and as a scheme to force the dealer who does sign the agreement to "boycott" the rivals of the trust.²⁶ Judge Sanborn expresses himself as follows:

The tobacco company and its employee sold its products to customers who refrained from dealing in the goods of its competitors at prices which rendered their purchases profitable. But there was no restriction upon competition here, because this act left the rivals of the tobacco company free to sell their competing commodities to all other purchasers than those who bought of the defendants, and free to compete for sales to the customers of the tobacco company by offering them goods at lower prices or on better terms than they secured from that company. The tobacco company and its employee were not required, like competitors engaged in public or quasi-public service, to sell to all applicants who sought to buy, or to sell to all intending purchasers at the same prices. They had the right to select their customers, to sell and refuse to sell to whomever they chose, and to fix different prices for sales of the same commodities to different persons. In the exercise of this right they selected those persons who would refrain from handling the goods of their competitors as their customers, by selling their products to them at lower prices than they offered them to others. There was nothing in this selection that was either illegal or immoral. It had no necessary effect to directly and substantially restrict free competition in any of the products of tobacco, and it did not unlawfully restrain interstate commerce, because it in no way restricted the exercise of the rights of the competitors of the tobacco company to fix the prices of their goods and the terms of their sales of similar products according to the dictates of their respective wills.²⁷

The issue is fairly joined in these two opinions. The question to be decided is whether the development of business on a large scale has altered conditions so much that agreements which were lawful, moral, and in accord with public policy when done on a small scale, have become immoral and against public policy, and hence should be made unlawful when a trust executes them. Has the difference in quantity become great enough to be a difference in kind? Judge Sanborn's opinion is that the trust is not engaged in public or quasi-public service, and is not obliged in law or morals to treat all comers alike; that it may choose those who

²⁶ See *supra*, p. 3 note.

²⁷ 125 *Fed. Rep.*, 461. For an exhaustive discussion of the legal aspect of the matter see *Hartman v. John D. Park & Sons Company*, 145 *Fed. Rep.*, 358 (Circuit Court, Eastern District of Kentucky, February 14, 1906).

distribute its products and pay them for the exclusive service. Professor Clark's presupposition, apparently, is that the combination is affected with a public use or interest, and may not discriminate between its customers, even though these purchasers are not consumers, but the agencies through which the trust puts its goods in the hands of the public. The exclusive service secured by the trust compels competitors to seek other agencies through which to reach the public, and he believes that this is an interference with free competition that should not be endured.

No one, presumably, would think of preventing one of a hundred manufacturers from making special prices to a dealer who would buy from him exclusively. Special agencies are such ancient and honorable instruments of competition that it is difficult to understand a classification of them as interferences with competition. Should they be so rated when the manufacturer is one of fifty? or of forty-five? or of forty? or of thirty? or of twenty? or, peradventure, of ten? It would puzzle more than human judgment to determine how many competitors are required to keep off the legislative fire and brimstone. There would be little left of the freedom of contract in case of indiscriminate regulation and no one knows where to discriminate when it is a difference in size merely. Effective regulation must turn on the quality of the action, not on the quantity, until the point is reached where the public nature of the business is unquestioned.

Undoubtedly the small producer of the less well-known goods has been put upon his mettle to meet the situation, but that is part of the competitive game and calls for no special sympathy or protection. It is his business to popularize his brands of goods and make it worth while for dealers to sell them. In all the cases cited where exclusive agencies were successful the producer had gone directly to the consumer through advertising, or otherwise, and created a demand that made it profitable to handle his goods. The scheme failed in the wall-paper business because it was impossible to educate the consumer to the point of demanding certain brands. No manufacturer will find much difficulty in putting his goods on the market if consumers demand them in sufficient quantity to make it profitable to handle them.

There does not seem to be any reason for believing that the consumer has suffered through the practice of creating exclusive agencies. In fact the whole structure rests on his demand for the articles in question. No dealer can satisfy all idiosyncrasies of taste with his stock of wares; some dealer can usually be found who has what one wishes; and sometimes one is persuaded to conform his desires to the desires of the general run of people. Some accommodation is inevitable under any system.

The retailer may feel that he has "a right" to handle what goods he pleases, and resent the regulation that requires him to push one producer's goods exclusively. He would like to make a profit on these and upon any others he might be able to sell, though a moment's reflection would probably convince him that, if let alone, he would have several kinds of the same goods on his shelves, with more capital tied up in them, and be selling the most popular of them at a margin that would narrow to extinction with unmitigated competition. Liberty for him would mean license to his competitors to wipe out profits on the bulk of sales in question. In all cases where exclusive agencies are created a gain on the business done is protected.

The upshot of this discussion may be put in a paragraph. The factor system is an expedient in the business world for the control of the distribution of goods by the manufacturers. It consists of a limitation of prices at which distributors may sell the products, with, frequently, a requirement that the distributor shall act as exclusive agent for the producer so far as his line of goods is concerned. The condemnation visited upon the first feature by the committee of the New York legislature is not supported by the facts to be found in its own report and in later investigations, as well as current trade literature. It is a scheme to which the economist can offer no objection, with which the courts usually do not interfere and do frequently indorse, and against which legislative action would be anything but advisable. Professor Clark has overemphasized the second in calling it the basis of the agreement. Moreover one cannot agree with him in denying to large businesses the right to employ exclusive agents in the distribution of their goods, or in asserting that such exclu-

sive agencies are interferences with free competition. The competitor who would be more than stimulated by such a scheme would hardly be worth the name.

The factor system is one of those, perhaps, minor institutions evolved to meet a particular need and likely to survive as long as the circumstances out of which it has come persist.²⁸

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²⁸ The reader may be interested in an article by Ellwood Pomeroy in the *Independent*, April 11, 1907, p. 851. Also *The Philistine*, November, 1906, p. 175.

For a discussion of limited prices in Britain see Macrostly, *The Trust Movement in British Industry* (1907), chaps. X and XII, and pp. 339-342.